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# Responding to Income Shifting by Multinational Corporations

# IncomeShifting

# **How Big is Profit Shifting?**

TPC/UNC Conference

Kimberly Clausing

21 May 2020

## How Big Is Profit Shifting?

- Abundant evidence of a very large problem.
- Magnitude depends on data source.
- Havens are the vast majority of the problem.
- \$3 trillion of \$4.2 trillion of reported accumulated foreign earnings in US country-by-country data (2017) are in havens, ignoring stateless numbers.

# Popular Data Sources

Orbis / Compustat = Company level data yet...

- Misses almost all haven income
- Nonlinearities are important => havens key
- Big companies do most shifting; don't treat all companies the same; the tail is different (Wier and Reynolds)
- Many companies report positive accounting profits and zero tax profits (Bilicka) => accounting data underestimates

Don't look under the lamppost for your keys if you dropped them in the dark.

# Other Data Sources

- BEA
  - Direct investment earnings series (preferred)
  - Net income (but double counting)
    - Subtracting equity income loses some profit shifting (among foreign countries); PTR has same problem
    - There are large amounts of untaxed foreign profit; foreign to foreign shifting is important.
  - In aggregate data, companies w/ losses make effective tax rates look too high.
- IRS Tax Form Data
  - Form 5471; one can omit dividends (but long lag)
  - Country by Country Data (form 8975; preferred)

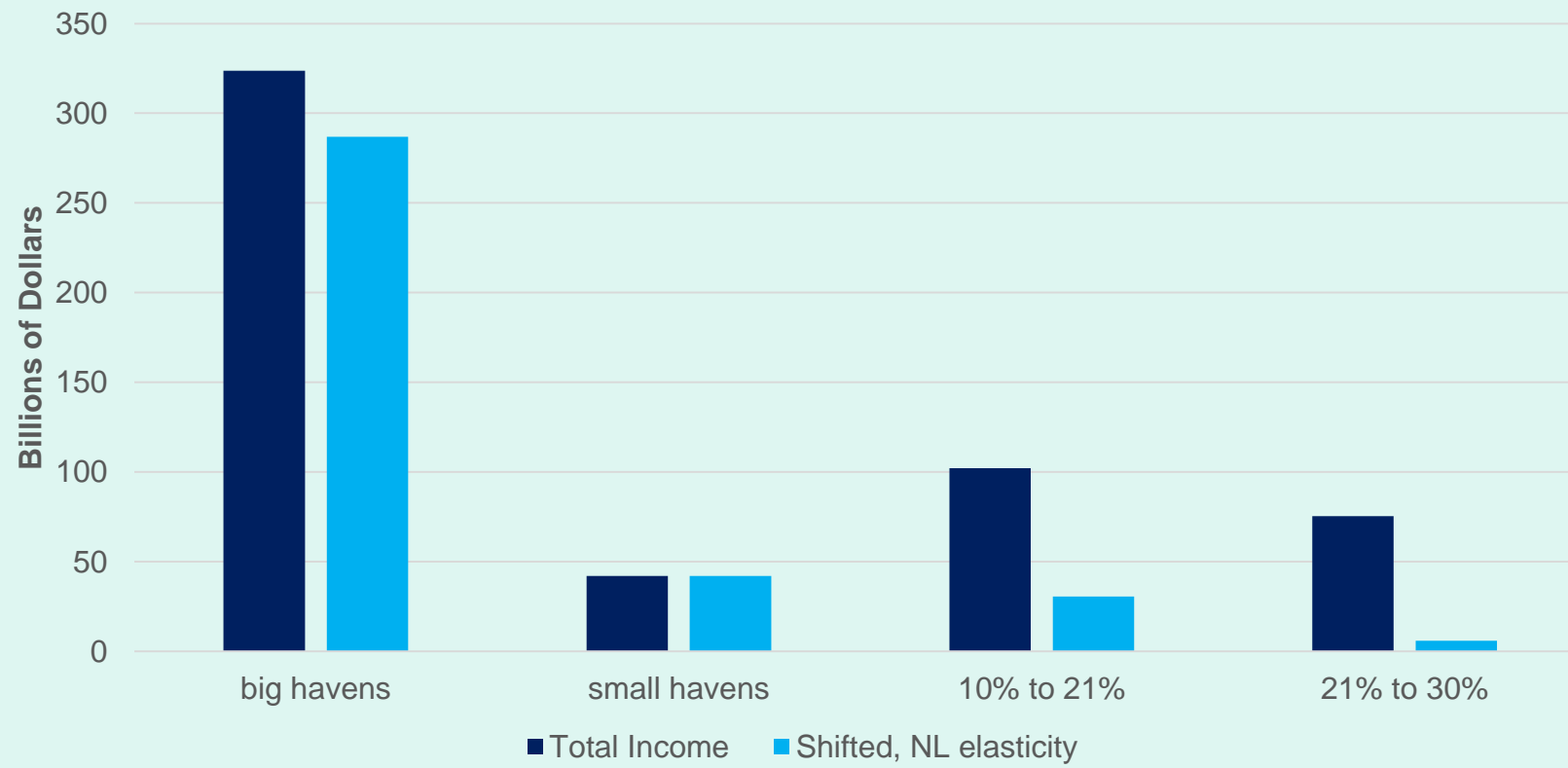
## A Comparison of US Data Sources in 2017

	<u>Adjusted Method (BR)</u>	<u>BEA Balance of Payments Direct Investment Income</u>		<u>IRS Country-by-country Data (income series are before tax)</u>		
	Net inc.+ for. tax- equity inc.	after tax (reported)	before tax (calculated) <sup>57</sup>	Full Sample	Positive Profit	Accumulated Earnings
<b>All countries<sup>58</sup></b>	<b>571,007</b>	470,933	<b>574,958</b>	<b>638,467</b>	873,621	4,240,635
<i>Stateless (omitted from totals and subtotals)</i>				203,571	215,170	690,583
Puerto Rico				34,335	35,236	114,439
Ireland	82,519	51,804	55,930	29,478	34,221	103,961
Luxembourg	6,484	36,825	38,734	24,866	60,438	357,328
Netherlands	58,676	76,083	81,120	40,010	69,964	461,814
Switzerland	37,696	30,474	34,332	49,376	59,204	374,797
<b>Bermuda</b>	<b>-10,431</b>	<b>32,341</b>	<b>33,215</b>	<b>32,476</b>	<b>35,433</b>	<b>634,413</b>
UK Caymans <sup>59</sup>	20,675	33,235	33,888	58,540	62,369	142,467
Singapore	35,270	24,496	27,529	54,642	56,788	174,888
<b>Big Haven Total</b>	230,889	285,258	304,748	323,723	413,653	2,364,107
<b>Big Haven Share</b>	40%		53%	51%	47%	56%

## Possible Scale of Revenue Loss from Profit Shifting in 2017

	BEA Direct Investment Income Series  (balance of payments data; adjusted pre-tax)	BEA Adjusted Income Series  (removes equity income from income, using BEA survey data)	IRS Full Country-by-Country Sample  (without stateless income)	IRS Average of Full and Positive Profit Country-by-Country Sample  (without stateless income)
Assign all havens <sup>19</sup> the world average profit/employee ratio	\$79 billion	\$61 billion	\$96 billion	\$118 billion
Remove tax elasticity; reallocate profits, linear elasticity	\$75 billion	\$67 billion	\$96 billion	\$122 billion
Remove tax elasticity; reallocate profits, nonlinear elasticity	<b>\$89 billion</b>	\$76 billion	<b>\$109 billion</b>	<b>\$141 billion</b>

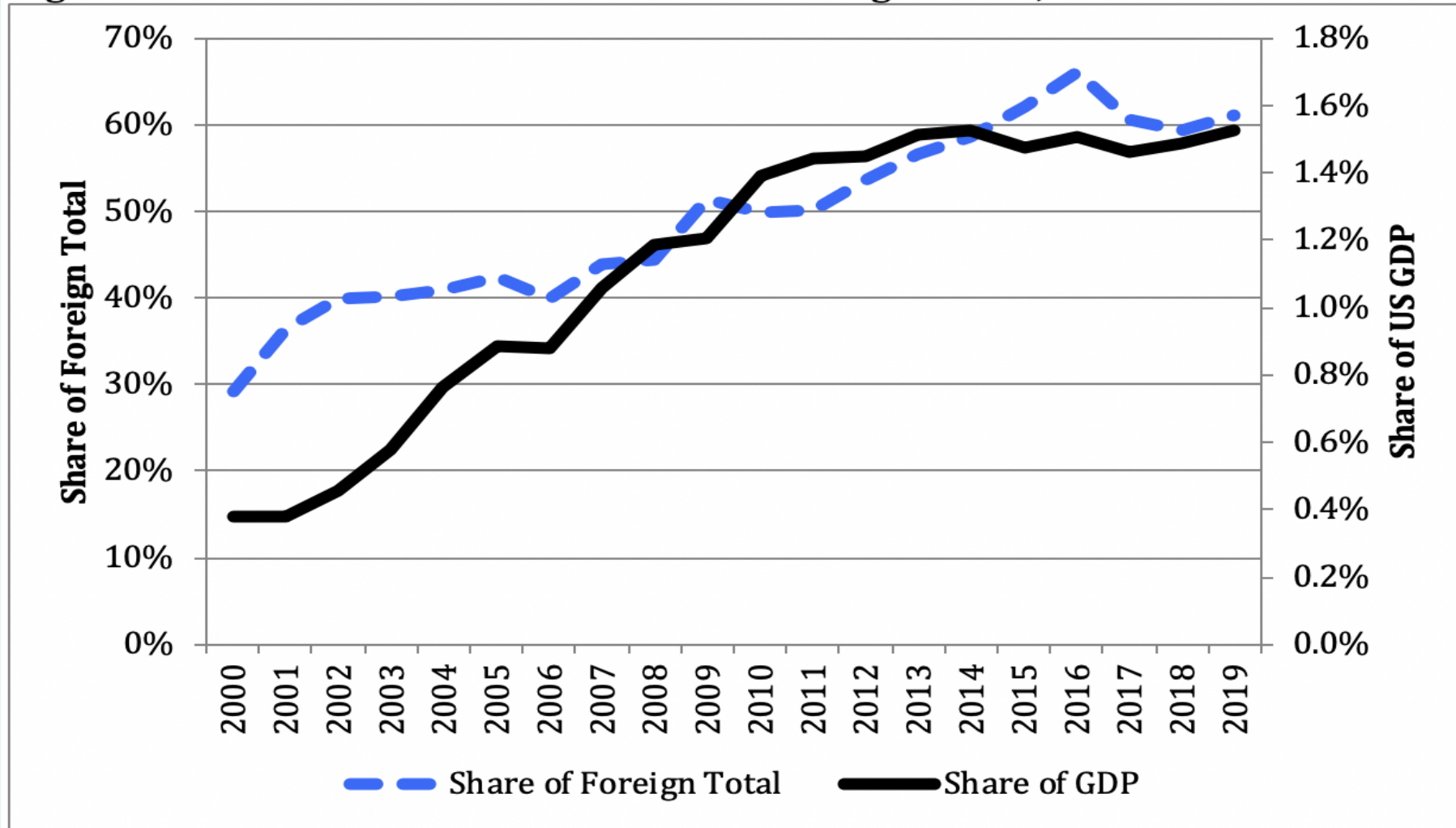
# Where are the profits (and the shifted profits)?





# What is the net effect so far of TCJA?

**Figure 2: Share of US MNC Income in Seven Big Havens, 2000-2019**





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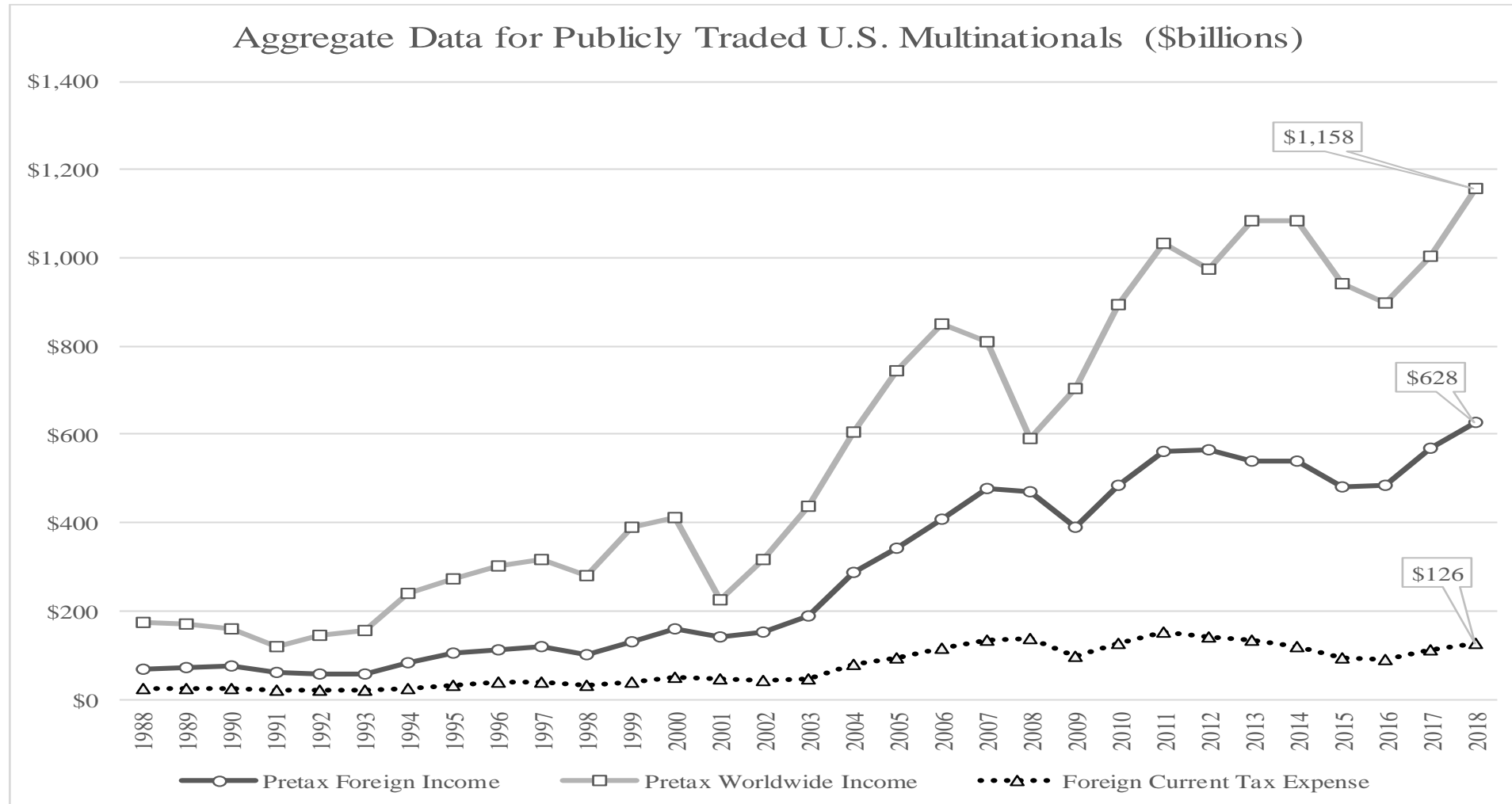
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# How Big a Problem is Income Shifting

Scott D. Dyreng

Duke University

# Aggregated Data from Public Filings

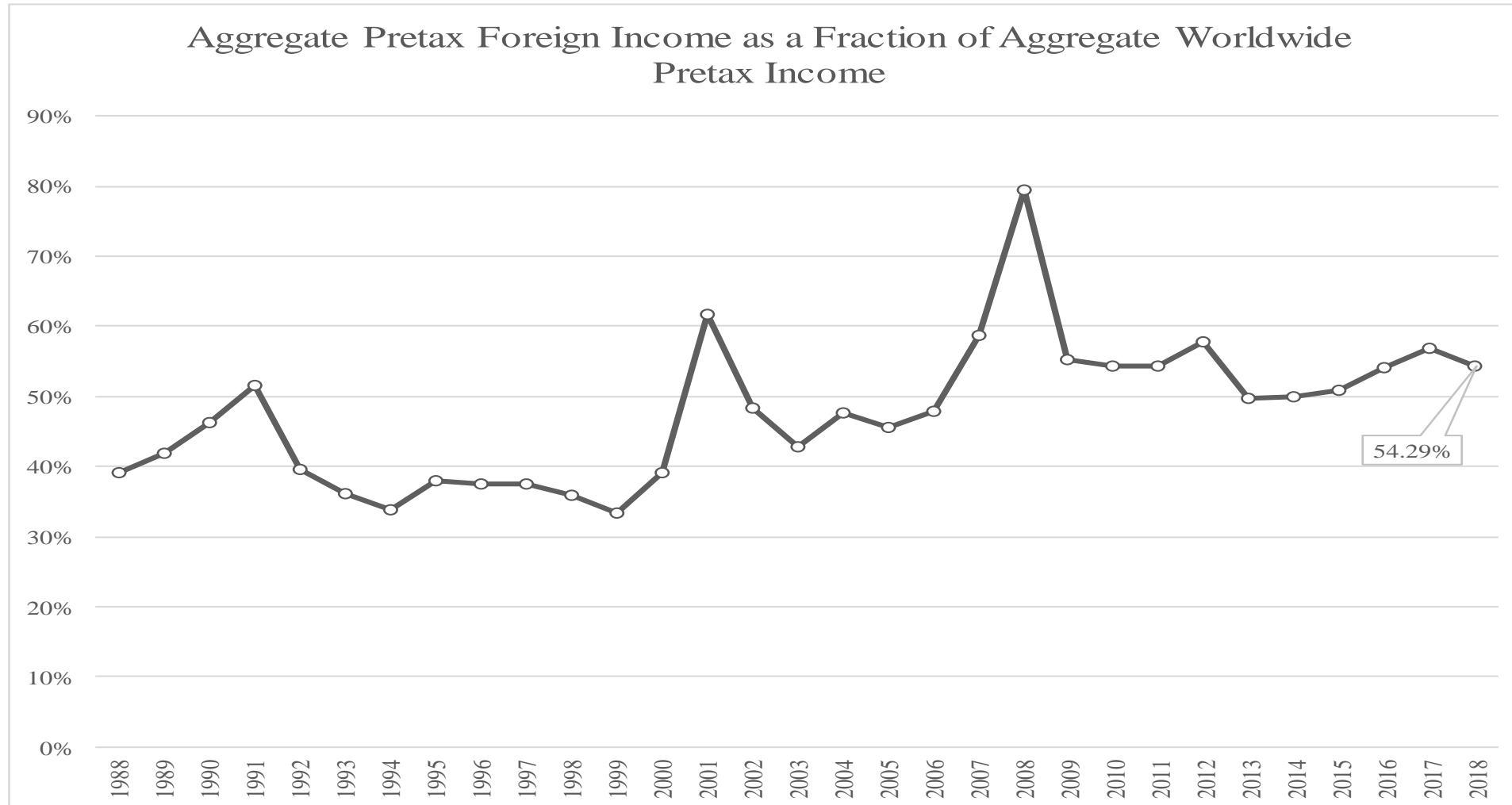


\$628 billion is an upper bound of income shifting for this sample

\$628 billion is likely too high because \$126 billion was paid in tax to foreign governments (about 20%).

The sample is all U.S. incorporated firms on Compustat with non-missing values for pretax foreign earnings, pretax worldwide earnings, total assets, and sales.

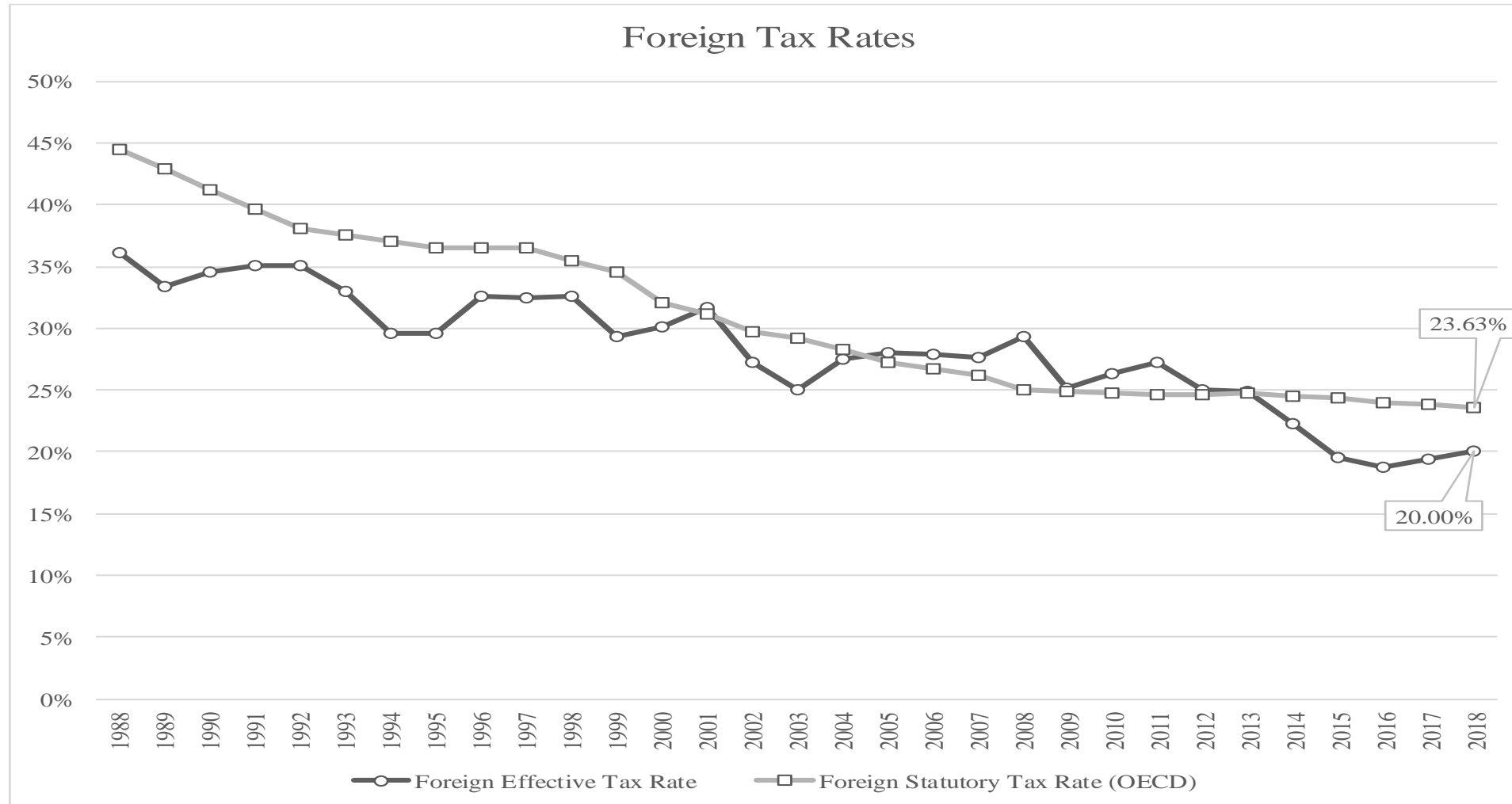
# Foreign Income as Percentage of Total Income



Using the *highest possible upper bound*, if all foreign earnings were recorded in tax havens, this would mean that a maximum of 54% of corporate earnings were recorded in tax havens in 2018 for this sample.

The sample is all U.S. incorporated firms on Compustat with non-missing values for pretax foreign earnings, pretax worldwide earnings, total assets, and sales.

# Foreign Taxes Paid



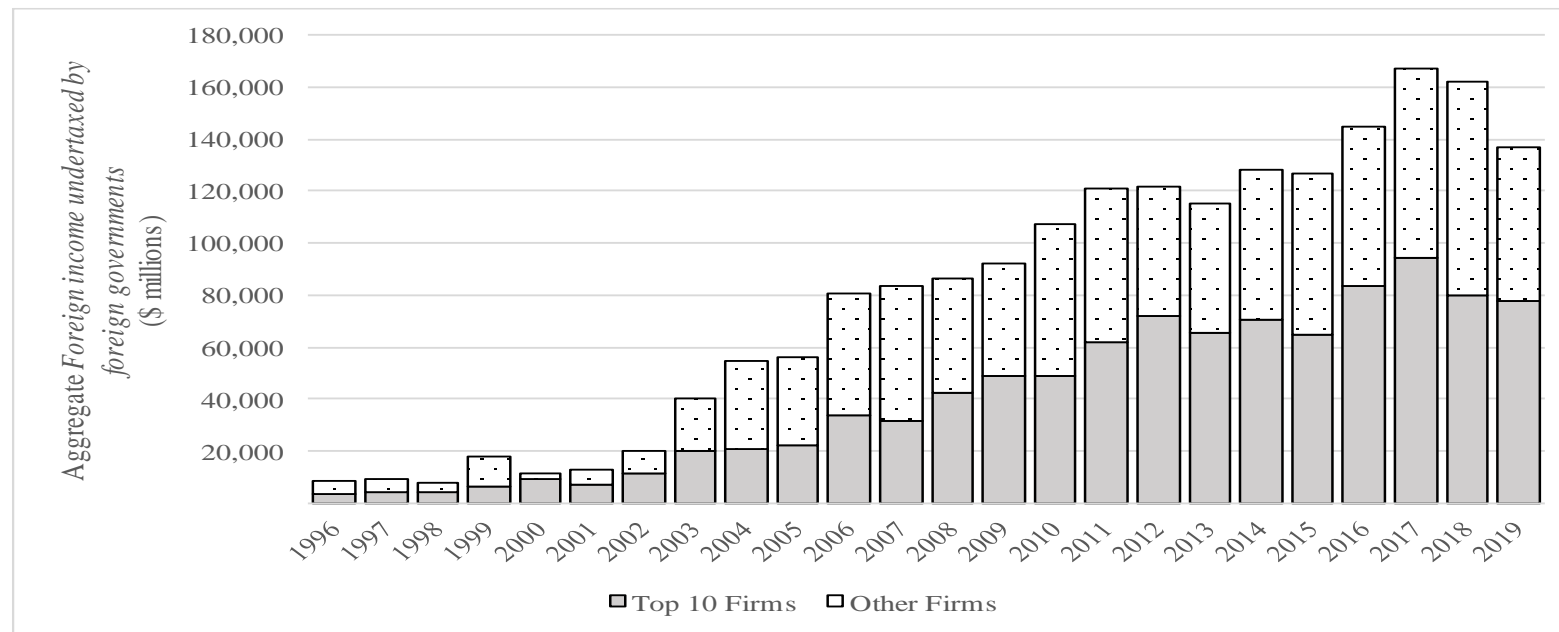
Note: the aggregate foreign effective tax rate is not that different from the OECD average statutory tax rate, suggesting a fairly large fraction of earnings for this sample is taxed by foreign governments.

The sample is all U.S. incorporated firms on Compustat with non-missing values for pretax foreign earnings, pretax worldwide earnings, total assets, and sales.

# Undertaxed Pretax Foreign Earnings (UPIFO)

see Dyreng Hills Markle (2020)

1-year measure	2017	2018	2019
Aggregate UPIFO	\$167 B	\$162 B	\$137 B
% of Foreign Income	19%	17%	18%
% in Top 10 firms	56%	49%	56%



# Caveats

- Publicly traded firms only
  - Likely not a huge problem because most profitable large private firms do not have extensive multinational operations based on intangible property. But is a weakness of this data.
- US firms only
  - Income shifting is a worldwide problem. U.S. firms might behave differently than other firms.
- Not capturing “shifted income” but instead capturing boundaries of how much could possibly be shifted.
- Financial Accounting vs Tax Accounting
  - Current foreign tax not exactly equal to foreign taxes paid in cash (but very close)
  - Pretax financial income not exactly equal to taxable income (but research suggests financial accounting income is usually higher than taxable income)
  - Lack of jurisdiction specific information (only have U.S vs Foreign)





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# DISTRIBUTION OF CORPORATE PROFITS ACROSS COUNTRIES

Leslie Robinson

Remarks for Panel Discussion

*Urban-Brookings Tax Policy Center and University of North Carolina Kenan-Flagler Business School*

## WHICH DATA SOURCE AND INCOME MEASURE SHOULD I USE TO STUDY INCOME SHIFTING?

- “the U.S. has a sophisticated system to monitor its multinationals: the BEA survey...Reporting is mandatory; the BEA has decades of experience with this survey, which has been used by many researchers” (Tørsløv et al. 2020)
- “U.S. tax data, the best possible data for studying [BEPS]” (Clausing (2020)); “perhaps even more promising in terms of accuracy is the use of confidential tax returns” (Garcia-Bernardo et al. 2019)
- “Compustat and Orbis are nearly useless for examining profit shifting” (Clausing 2020)
- CbyCR data, released for the first time in December 2018, has been immediately declared as “the most reliable country-level information about [MNEs] tax payments and profits to date” (Garcia-Bernardo et al. 2019)

HOW MUCH FOREIGN INCOME WAS EARNED IN  
AGGREGATE ACROSS ALL U.S. MNES IN 2012?  
(IN BILLIONS)

- **\$1,219** (BEA pre-tax income)
- **\$438** (BEA direct investment income – after-tax)
- **\$919** (BEA adjusted direct investment income – pre-tax)
- **\$543** (BEA adjusted pre-tax income; see Blouin and Robinson 2020 & <https://www.bea.gov/help/faq/1402>) & [\$152.7 foreign taxes]
- **\$537** (BEA profit-type return)
- **\$670** (Treasury – CFC pre-tax E&P excluding related party dividends) & [\$130.8 foreign taxes]
- **\$523** (Compustat – foreign pre-tax income) & [\$153.7 foreign taxes]

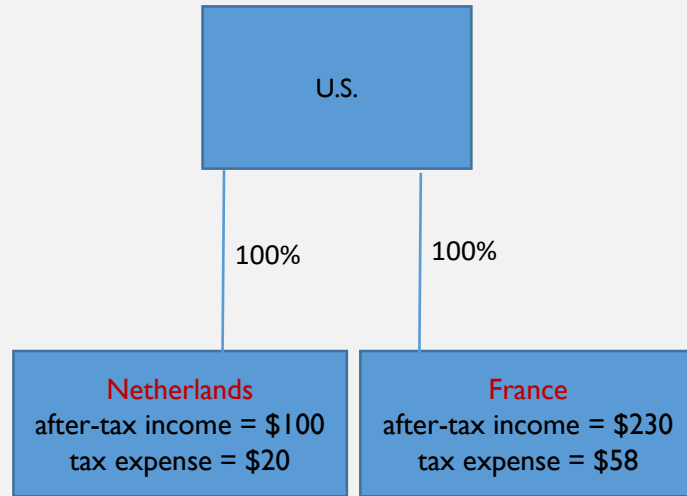
HOW MUCH FOREIGN INCOME WAS EARNED IN  
AGGREGATE ACROSS ALL U.S. MNES IN 2012 IN THE  
NETHERLANDS? (IN BILLIONS)

- **\$172** (BEA pre-tax income)
- **\$75** (BEA direct investment income – after-tax)
- **\$132** (BEA adjusted direct investment income – pre-tax)
- **\$10** (BEA adjusted pre-tax income; see Blouin and Robinson 2020 & <https://www.bea.gov/help/faq/1402>)
- **\$16** (BEA profit-type return)
- **\$71** (Treasury – CFC pre-tax E&P excluding related party dividends)
- **\$???** (Compustat – not disaggregated by country)

WHAT PROPORTION OF FOREIGN INCOME WAS  
EARNED ACROSS ALL U.S. MNES IN 2016 IN BERMUDA,  
CAYMAN ISLANDS, SINGAPORE, SWITZERLAND,  
LUXEMBOURG, NETHERLANDS, IRELAND?

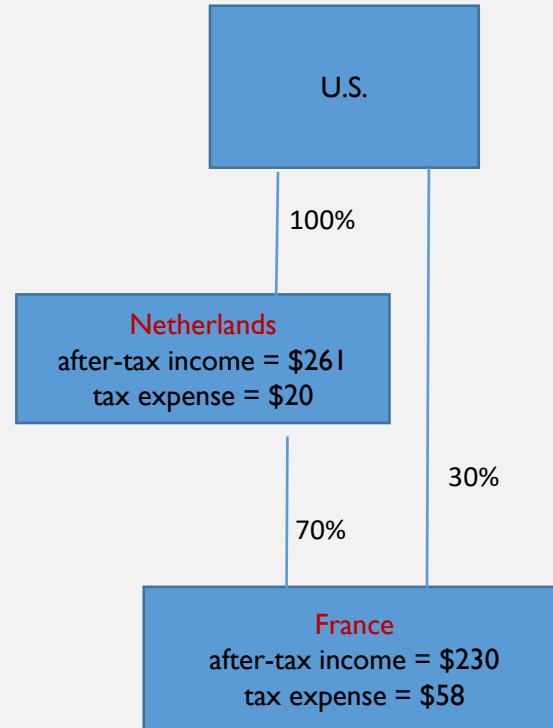
- **62%** (BEA pre-tax income)
- **66%** (BEA direct investment income – after-tax)
- **41%** (BEA adjusted pre-tax income; see Blouin and Robinson 2020 & <https://www.bea.gov/help/faq/1402>)
- **66%** (Treasury – CFC pre-tax E&P excluding related party dividends)
- **33%** (Treasury – CbyCR pre-tax profit - 2016)
- **45%** (Treasury – CbyCR pre-tax profit - 2017)

# TIERED OWNERSHIP STRUCTURES AND THE DISTRIBUTION OF CORPORATE PROFITS (BEA)



Direct investment income = Net income

Netherlands: \$100 DII & NI  
 France: \$230 DII & NI  
 Foreign: \$330 DII & NI



Direct investment income ≠ Net income

Netherlands: \$261 DII vs. \$261 NI  
 France: \$69 DII vs. \$230 NI  
 Foreign: \$330 DII vs. \$491 NI



Direct investment income ≠ Net income

Netherlands: \$330 DII vs. \$330 NI  
 France: \$0 DII vs. \$230 NI  
 Foreign: \$330 DII vs. \$560 NI

# SEE BLOUIN AND ROBINSON (2020)

**Table 3**  
**Comparisons of BEA Data, CFC Data, and CbyCR Data**

	Year 2016						
	BEA Reporting-Based Measures			IRS Form 5471 Dividends Received from Related Parties			IRS Form 8975
	DII	PTI	Adj. PTI	Pre-Tax E&P	Adj. E&P	Pre-Tax Income	
Ireland	52,366	153,615	77,369	202,280	40,018	162,262	31,390
Luxembourg	34,819	102,212	(963)	86,251	47,018	39,233	(2,139)
Netherlands	72,130	182,552	14,675	197,133	112,880	84,253	37,642
Caribbean	26,279	59,317	11,850	45,587	14,304	31,283	26,082
Bermuda	41,554	79,532	(1,602)	108,415	23,951	84,464	24,900
Singapore	25,002	43,809	27,573	28,922	5,399	23,523	29,040
Switzerland	30,321	71,951	43,098	63,021	20,291	42,730	(6,204)
Foreign income – All countries	427,542	1,110,164	420,065	1,071,013	365,422	705,591	431,813
% in Tax Havens	66%	62%	41%	68%	72%	66%	33%





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